

1-1978

I.R.C. Section 119: Is Convenience of the Employer a Valid Concept

Adrian A. Kragen

Klonda Speer

Follow this and additional works at: https://repository.uchastings.edu/hastings_law_journal



Part of the [Law Commons](#)

Recommended Citation

Adrian A. Kragen and Klonda Speer, *I.R.C. Section 119: Is Convenience of the Employer a Valid Concept*, 29 HASTINGS L.J. 921 (1978).
Available at: https://repository.uchastings.edu/hastings_law_journal/vol29/iss5/6

This Article is brought to you for free and open access by the Law Journals at UC Hastings Scholarship Repository. It has been accepted for inclusion in Hastings Law Journal by an authorized editor of UC Hastings Scholarship Repository. For more information, please contact wangangela@uchastings.edu.

I.R.C. Section 119: Is Convenience of the Employer a Valid Concept?

By ADRIAN A. KRAGEN*

KLONDA SPEER**

The operation of the income tax laws has long been considered a competitor to the pyramids as a mysterious phenomenon. Laymen and even many lawyers consider the structure of the income tax laws to be incomprehensible and, what is worse, inequitable. The multitude of interpretations by the courts and the Internal Revenue Service has compounded the confusion. In recent years there have been many statements by the media and by commentators on the tax system to the effect that the tax laws impact unequally on the rich and the poor and that the person of means can hire the talent, legal or accounting, to insure the minimization or even elimination of tax liability. We also know that the average citizen has extreme difficulty in understanding the concept that "income" for tax purposes includes all realized accessions to wealth. The idea that the money that Cesarini¹ found in the piano or that James² embezzled should constitute taxable income to them is extremely hard for the average taxpayer to comprehend. Such taxpayer may applaud the idea that Duberstein³ should be forced to include in income the value of the Cadillac his friend gave to him, but he is hard put to reconcile this with the fact that another individual might be allowed to give the same model Cadillac to a good friend without incurring any income tax liability.

* Professor of Law, Hastings College of the Law; Professor Emeritus, University of California at Berkeley. A.B., 1931, J.D., 1934, University of California at Berkeley.

** B.A., 1967, University of Kansas. Member, Second Year Class.

1. *Cesarini v. United States*, 296 F. Supp. 3 (N.D. Ohio 1969), *aff'd per curiam*, 428 F.2d 812 (6th Cir. 1970).

2. *James v. United States*, 366 U.S. 213 (1961).

3. *Commissioner v. Duberstein*, 363 U.S. 278 (1960).

This same lack of understanding of statutorily, administratively, or judicially imposed tax rules pervades the area to be considered in this Article. Individuals who think about the subject (and there appear to be few) voice bewilderment at the fact that waiters who eat at the establishment at which they work may not be required to include the value of their meals in income for income tax purposes while the accountant for the restaurant eating meals at the same place would probably have to include their value as a part of gross income. Equally bewildering is the fact that an executive who is furnished luxurious housing by his employer might not be required to pay rent or to include its value in income for federal income tax purposes.

In view of the substantial amount of discussion concerning the imperfections of our federal tax system and its apparent inequities,⁴ it is somewhat surprising that there has been so little public comment⁵ in regard to the operation of Internal Revenue Code section 119.⁶ It is the authors' position that section 119 as currently interpreted results in inconsistent treatment of taxpayers similarly situated, as well as substantial revenue loss,⁷ and that the section should be repealed or amended to remove the reasons for its current inequitable operation.

The Common Law Rule

Section 119 does not represent a recent development in the law, nor is that section really the creature of congressional action or of

4. See, e.g., P. STERN, *THE RAPE OF THE TAXPAYER* (1973).

5. For treatment of § 119 in response to specific cases or problems, see Hipple, *New Third Circuit Decision Expands Meals Exclusion Under Section 119*, 40 J. TAX. 330 (1974); Jordan, *Can Cash Payments to Employees Be Excluded as Meals Under Section 119?*, 45 J. TAX. 310 (1976); Note, *Internal Revenue — Section 119 — Meaning of "Business Premises of the Employer,"* 33 Mo. L. REV. 163 (1968).

6. Section 119 reads as follows: "There shall be excluded from gross income of an employee the value of any meals or lodging furnished to him by his employer for the convenience of the employer, but only if—

(1) in the case of meals, the meals are furnished on the business premises of the employer, or

(2) in the case of lodging, the employee is required to accept such lodging on the business premises of his employer as a condition of his employment.

In determining whether meals or lodging are furnished for the convenience of the employer, the provisions of an employment contract or of a State statute fixing terms of employment shall not be determinative of whether the meals or lodging are intended as compensation."

7. Estimated to be \$330-400-million in 1977. STAFF OF JOINT COMM. ON TAXATION, 95TH CONG., 2d SESS., *ESTIMATES OF FEDERAL TAX EXPENDITURES* (Comm. Print 1977).

lobbying by special interest groups. For a long period prior to the enactment of section 119, the Internal Revenue Service and the courts tussled with the question of when meals and lodging furnished by an employer should be excluded from the gross income of the employee.

As early as 1921, the Treasury ruled in an office decision that lodging furnished for the convenience of the employer was excludable from income if it was not regarded as part of the compensation of the employee.⁸ That ruling and a number of others in the 1920's and 1930's simply stated, without explanation, that, if the furnishing of meals and lodging was not intended as compensation and was for the convenience of the employer, the value was not included in income.⁹ These pronouncements contained no analysis or reasoning and did not consider the possibility that, at least to some extent, there may have been an unexpressed compensation factor even when convenience of the employer was determined to be the primary factor. There was in fact practically no definition of what constituted "employer convenience." An examination of the early rulings indicates that the Service was somewhat confused as to whether, in addition to the requirement that the furnishing of such items be for the convenience of the employer, it was necessary that the employer require the employee to use the meals or lodging.¹⁰

The first major case to consider the general problem of the exclusion of employer-furnished meals and lodging was *Jones v. United States*.¹¹ The question in *Jones* concerned the inclusion of the value of quarters furnished to United States Army officers and commutation furnished in lieu thereof. Although the opinion primarily addressed the issue of congressional intent concerning the validity of distinguishing between pay and allowances, the court made some statements indicating the criteria it considered appropriate in a determination

8. O.D. 914, 4 C.B. 85 (1921). Not all of the earlier decisions concerning what would now be a § 119 question mentioned the term "convenience of the employer." None offered guidelines for exclusion. O.D. 814, 4 C.B. 84, 84-5, (1921); O.D. 514, 2 C.B. 90 (1920); O.D. 265, 1 C.B. 71 (1919); O.D. 11, 1 C.B. 66 (1919).

9. E.g., O.D. 915, 4 C.B. 85 (1921); I.T. 2253, V-1 C.B. 32 (1926).

10. Compare O.D. 514, 2 C.B. 90 (1920) (no mention of employees being required to accept supper money) and T.D. 2992, 2 C.B. 76 (1920) (convenience of employer only requirement) with O.D. 915, 4 C.B. 85, 85-86 (1921) (hospital employees subject to 24-hour call "and on that account are required to accept quarters and meals") and T.D. 4965, 1940-1 C.B. 13 (restatement of "convenience of employer" rule to include "required to accept" test).

11. *Jones v. United States*, 60 Ct. Cl. 552 (1925).

that meals or lodging should be excluded from income. The court stated that "[t]he officer is not paid a salary and furnished a house to live in for his services; he is, on the contrary, paid a salary *to live* in the quarters furnished."¹² The court further endeavored to demonstrate that it considered this to be an absurd attempt by the Internal Revenue Service to include quarters in income on the basis that, if quarters were not furnished, the officer would have to rent lodging. The court noted that no one would expect a government attorney to pay income tax on the value of an office furnished to him simply because an attorney in private practice would be forced to rent his own office. Therefore, reasoned the court, just as the government official would not be required to add to income the value of his office, the Army officer should not be required to include in income the value of his quarters. In neither case would the individual be able to do his job for the employer without those facilities.¹³

Subsequent to *Jones*, both the Internal Revenue Service and the courts issued rulings on a variety of specific fact situations with little explanation for the rulings beyond a refusal to exclude meals or lodging from income unless it was shown that they were not intended as compensation to the employee. In *Kitchen v. Commissioner*¹⁴ the court held that the value of meals and lodging furnished a hotel manager and his wife were includable in income because there was no showing that they were furnished *solely* for the convenience of the employer and further, there was no showing that the wife had performed services. Three years later the same court held in *Benaglia v. Commissioner*¹⁵ that meals and lodging furnished a hotel manager and his wife were excludable because they were furnished solely on the basis that the manager could not otherwise perform his duties. The facts in *Kitchen* and *Benaglia* as recited in the opinions are not distinguishable, and further there was no evidence in *Benaglia* relative to services furnished by the wife. In *Ellis v. Commissioner*¹⁶ the court departed from the "solely" requirement and held that an apartment house manager was entitled to allocate and therefore to exclude a portion of the lodging's value when the apartment was furnished in part for the convenience of the employer. In *Papineau v. Commissioner*¹⁷ the

12. *Id.* at 570.

13. *Id.* at 577.

14. 11 B.T.A. 855 (1928).

15. 36 B.T.A. 838 (1937).

16. 6 T.C. 138 (1946).

17. 16 T.C. 130 (1951).

court ignored the "solely" question altogether and, in allowing an unallocated exclusion, disregarded any value to the employee from the lodging furnished to a hotel manager.¹⁸

In *Carmichael v. Commissioner*,¹⁹ the court narrowed the range of cases in which the convenience of the employer test would be satisfied. The court examined the situation of a number of employees of a government housing project and stated that convenience of the employer means "not merely the request, direction or pleasure of the employer but that the inherent nature of the employment requires that the employee occupy premises supplied by the employer"²⁰ The difficulty of application of this test was illustrated by the court's own effort in this regard when it held that employees who were not required to be on duty twenty-four hours were required to include the value of housing in income but made an exception for an elderly lady on the night shift who, because of her age, could not go to and from the place of employment.

Contemporaneously with the above rulings the courts began to return to the distinction between those cases in which there was evidence of an intent to compensate and those in which such evidence was not present and began to expand the area where exclusion was held not to be proper.²¹ The courts began to find an intent to compensate when the employee was required to live or take meals for the convenience of the employer but the employer deducted some amount for the lodging or meals and held such amount to be includable in income. In *Doran v. Commissioner*²² the Tax Court denied the exclusion and stated that compensation and convenience of the employer are not alternative propositions;²³ rather convenience of the employer is only one factor in determining whether the value

18. A much-quoted revenue ruling furnished a basis for disregarding the compensation factor altogether: "If, however, the living quarters or meals furnished are not compensatory or are furnished for the convenience of the employer, the value thereof need not be added to the compensation otherwise received by the employee." *Mim.* 5023, 1940-1 C.B. 14, 15 (emphasis added).

19. 7 T.C.M. (CCH) 278 (1948).

20. *Id.* at 281.

21. The Commissioner had tightened the requirements for exclusion in *Mim.* 6472, 1950-1 C.B. 15, where "convenience of the employer" was defined as "simply an administrative test to be applied only in cases in which the compensatory character of such benefits is not otherwise determinable."

22. 21 T.C. 374 (1953).

23. *Id.* at 376.

of living quarters is compensation. These new holdings increased the inequity in the determination of when the furnishing of meals or lodging was not an item of income. If lodging and meals were provided admittedly for the convenience of the employer and the employee was required to accept the meals or lodging, there would appear to be no logical basis for differentiation between apartment manager A who was paid a salary of \$500 per month and required to live in an apartment, the normal rental of which was \$300, and B who was paid \$800 per month and required to live in an apartment with the landlord deducting \$300 per month. In fact, two years after *Doran* the Second Circuit, in *Diamond v. Sturr*,²⁴ adopted the above reasoning, declared the Commissioner's position "arbitrary and formalistic,"²⁵ and allowed a State employee to exclude even though his meals and lodging were characterized as compensation by operation of State law.

As the examples given above illustrate, the rulings and cases lacked cohesiveness and certainty to the extent that it became nearly impossible to advise employers and employees as to their tax liability. Semantic criteria imposed by the IRS and the courts made the ultimate results devoid of reality. It was comparatively easy to devise a plan under which an employee could avoid inclusion in income of lodging and meals if the nature of the employer's business was such as to give some support to the concept that the items were furnished for the employer's convenience. If, however, for the purpose of an employer's accounting records or his complying with requirements of a regulatory authority or a governmental employer there was an amount recorded as a "charge" for the meals and lodging, the unfortunate employee would be required to include the value in income although the transaction realistically was no different than if there had been no such recording.²⁶ Only if the employee could prove the entry was solely for bookkeeping purposes and not a true charge could the value of the accommodations possibly be excluded.²⁷ There was no assurance, however, that exclusion would be the result. The cases also indicated much uncertainty as to whether it was sufficient that there simply be a right of choice to use the facilities or

24. 221 F.2d 264 (2d Cir. 1955).

25. *Id.* at 268.

26. Mim. 6472, 1950-1 C.B. 15.

27. *Farnham v. Commissioner*, 6 T.C.M. (CCH) 1049 (1947).

whether there needed to be a definite requirement that such facilities be used.²⁸

In what was proclaimed to be an effort to obtain some uniformity of determination and to set forth guidelines for the unwary, the 1954 codification included, as section 119,²⁹ a specific provision excluding meals and lodging furnished for the convenience of the employer if they meet the criteria set forth in the statute.

Section 119 of the 1954 Code

The original measure proposed by the House contained no reference to the term "convenience of the employer." It provided instead that meals and lodging were to be excluded from the employee's income if they were furnished at the place of employment and if the employee was required to accept them as a condition of employment.³⁰ The Senate added the convenience of the employer requirement as the third test of the section and substituted the language "business premises of the employer" for "place of employment."³¹ Both the House and Senate were particularly concerned that the section address the Service's position that characterization of meals or lodging as compensation required their inclusion in income.³² Therefore section 119 provided that, even though the lodging or meals were characterized by the employer as compensation, they should not be included in income as a result of that fact alone if the other requirements of the rule were met.³³ In the last sentence of the section the Senate sought to emphasize that, when an employee otherwise meets the requirements of section 119, the exclusion will not be defeated by the fact that state law regards his meals and lodging as part of his compensation. In addition, the Senate gloss to the bill indicated that the exclusion applies only to meals and

28. See *Bennett v. Commissioner*, 1 T.C.M. (CCH) 31, 38-39 (1942); Mim. 6472, 1950-1 C.B. 15-16; Mim. 5023, 1940-1 C.B. 14-15.

29. See note 6 *supra*.

30. H.R. REP. No. 1337, 83d Cong., 2d Sess., reprinted in [1954] U.S. CODE CONG. & AD. NEWS 4017, 4042, 4175-76.

31. S. REP. No. 1622, 83d Cong., 2d Sess., reprinted in [1954] U.S. CODE CONG. & AD. NEWS 4621, 4825-26.

32. See Mim. 6472, 1950-1 C.B. 15; *Doran v. Commissioner*, 21 T.C. 374 (1953). See notes 21-22 & accompanying text *supra*.

33. H.R. REP. No. 1337, 83d Cong., 2d Sess., reprinted in [1954] U.S. CODE CONG. & AD. NEWS 4017, 4175.

lodging furnished in kind and that cash allowances would continue to be includable in gross income "to the extent that such allowances constitute compensation."³⁴

Notwithstanding the expressed intention of the legislature to "end the confusion" surrounding the convenience of the employer rule,³⁵ the Senate amendments to H.R. 8300 as adopted were the source of much comment when the Commissioner and courts began to apply section 119. The addition of the common law term, "convenience of the employer," as a third test was interpreted in two different ways: either as evidencing an intent to continue the exclusions formerly allowed by the rule³⁶ or, in other instances, as again emphasizing that an employee would not be denied the exclusion on the basis of the employer's characterization of the meals or lodging as compensatory, when the actual conditions of employment made the furnishing of meals or lodging necessary in order for the employee to perform his work properly.³⁷ The Senate's substitution of "business premises" for the term "place of employment" in the House bill has also caused confusion. Both terms were intended to have the same effect.³⁸ However, courts have justified a broad reading of the "business premises" test.³⁹ For example, in the state trooper cases "business premises" of the state has been held to mean all areas within its boundaries.⁴⁰ Finally, the Senate comment that cash payment would be included in gross income "to the extent that it represents compensation"⁴¹ has been an additional source of confusion. The Senate comment has been used to buttress the position of many state troopers who received cash reimbursements for their meals in their argument that where the other requirements of section

34. S. REP. NO. 1622, 83d Cong., 2d Sess., *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4621, 4825.

35. H.R. REP. NO. 1337, 83d Cong., 2d Sess., *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4017, 4042.

36. See text accompanying notes 131-40 *infra*.

37. *Dole v. Commissioner*, 43 T.C. 697, 706, *aff'd per curiam*, 351 F.2d 308 (1st Cir. 1965).

38. The conference report stresses that even under the changed wording a room furnished a domestic servant in the employer's home will be regarded as on the "business premises." H.R. REP. NO. 2543, 83d Cong., 2d Sess., *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 5280, 5286.

39. *Dole v. Commissioner*, 43 T.C. 697, 709-11 (Scott, J., concurring), *aff'd per curiam*, 351 F.2d 308 (1st Cir. 1965).

40. See text accompanying notes 89-94 *infra*.

41. S. REP. NO. 1622, 83d Cong., 2d Sess., *reprinted in* [1954] U.S. CODE CONG. & AD. NEWS 4621, 4825.

119 were met, the reimbursement was "noncompensatory" and therefore excludable.⁴² A more logical interpretation is that the Senate committee simply intended to make clear that meals and lodging deductible under Internal Revenue Code section 162 would not be affected by the provisions of section 119.⁴³

The premise underlying exclusion in section 119 is that the greater the employer's control of the employee's enjoyment of the meals or lodging, the less likely they will be considered as compensation and the less directly will the employee be held to have been benefited. If the employee is benefited only indirectly, the value of the accommodations provided will be excluded from income, even though some compensation factor is present. In enacting section 119, Congress intended to allow the exclusion in two situations: when the employee who is required to be continuously on call is provided meals or lodging on the premises where he or she performs the work and when the employer must furnish eating or lodging facilities in order for work to be performed, because no accommodations are available otherwise. In both of these situations, the employer exerts a maximum amount of control over the employee's enjoyment of the meals and lodging.

Notwithstanding congressional attempts to establish clear criteria for exclusion which could be easily applied, passage of section 119 did not cure the uncertainty surrounding the convenience of the employer rule. Courts at all levels have denied exclusions to some employees when it clearly appeared that the section was intended to cover their situations and have granted exclusions to other employees when it is questionable that the statute so intended.

Interpretation of Section 119

Convenience of the Employer

The "convenience of the employer" and "required as a condition of employment" criteria have been merged consistently by the courts⁴⁴ and therefore will be treated together in this Article. Both tests have been reinterpreted to require a showing that the employment may

42. *E.g.*, *United States v. Morelan*, 356 F.2d 199, 204 (8th Cir. 1966).

43. *Commissioner v. Kowalski*, 98 S. Ct. 315, 325 (1977).

44. *See United States Junior Chamber of Commerce v. United States*, 334 F.2d 660, 663-64 (Ct. Cl. 1964).

be performed properly only if the employer furnishes lodging or meals.⁴⁵ Accordingly, it is not necessary that an employee be formally required by his employer to accept the accommodation in order that its value be excluded from income, so long as the employee's presence is necessary to the functioning of the business.⁴⁶ If an employer merely prefers that the employee accept the meals or lodging,⁴⁷ however, their value normally will not be excluded from the employee's gross income.⁴⁸

Early cases examined the convenience of the employer test in light of the amount of choice exercised by the employee notwithstanding the fact that he ostensibly was required by his employer to accept the housing.⁴⁹ In *Olkjer v. Commissioner*,⁵⁰ the court held the value of housing and meals excludable when only employer-furnished housing was available to the taxpayer, a project engineer on a construction job in Greenland, on the ground that the employee had no choice but to accept the housing. Additionally, lack of availability of housing will not be a factor if the employee must be constantly on call in order to perform his job.⁵¹

45. S. REP. NO. 1622, 83 Cong., 2d Sess., reprinted in [1954] U.S. CODE CONG. & AD. NEWS 4621, 4825; Min. 5023, 1940-1 C.B. 14; Treas. Reg. § 1.119-1(b), T.D. 6745, 1964-2 C.B. 42.

46. *Caratan v. Commissioner*, 442 F.2d 606, 609 (9th Cir. 1971); *United States Junior Chamber of Commerce v. United States*, 334 F.2d 660, 662 (Ct. Cl. 1964). "It seems to us that the practical imperative should govern, rather than an express order by the employer, for the latter could be dissimulated." *Adams v. United States*, 77-2 U.S. Tax Cas. ¶ 9613 (Ct. Cl. 1977).

In *Dole v. Commissioner*, 43 T.C. 697, 705-06 (1965), the court concluded that, even though mill employees were required to be on 24-hour call and no other housing was available close to the mill, the rental value of housing could not be exempted because the employer merely expressed a preference that the employees live in the houses. *Dole* was affirmed *per curiam*, 351 F.2d 308 (1st Cir. 1965), on the basis of the concurring opinion by Judge Raum which strictly interpreted the business premises test, thus reinforcing the position that form need not be exalted when applying the "required as a condition of employment" test.

47. Although § 119 does not apply the "required as a condition of employment" criterion to meals furnished by the employer, this requirement may be a factor in determining whether the meals are furnished for the convenience of the employer. Treas. Reg. § 1.119-1(a)(2)(i), -1(a)(3)(i), -1(d)(1), T.D. 6745, 1964-2 C.B. 42. Accordingly meals and lodging exclusions will be discussed together here. When divergences in the treatment of the exclusions occur in the cases they will be noted.

48. *Heyward v. Commissioner*, 36 T.C. 739, 745 (1961).

49. If the employee may choose whether or not to accept the housing or meals, the value is, of course, not excludable. Treas. Reg. § 1.119-1(a)(3)(i), -1(b)(2), -1(d)(6), T.D. 6745, 1964-2 C.B. 42.

50. 32 T.C. 464 (1959).

51. "In light of the specific language of Treas. Reg. § 119-1(b), it does not appear

The court in *United States Junior Chamber of Commerce v. United States*⁵² considered availability of housing not to be a stumbling block for exclusion even when the employee was not on twenty-four-hour call.⁵³ In that case, the United States Junior Chamber of Commerce furnished a large residence (the "White House") in Tulsa to its president, a member elected to a one-year term. The president's position required that he entertain extensively and that he frequently hold evening business meetings. The Service did not dispute the fact that the official functions of the president required the use of such a house but denied the exclusion because, with other suitable residences available in the area, it was not necessary for the employer to furnish the particular house to the employee. The Court of Claims held the rental value of the house properly excluded from the employee's income, pointing out that if choice alone were the issue, even Mr. Olkjer⁵⁴ could have been required by his employer to provide his own housetrailer at the jobsite. The court refused to adopt a strict construction of the rule, noting that few cases could satisfy such an "abstract concept of necessity."⁵⁵ The test would be satisfied when "as a practical matter" the employee must accept the lodging.

Providing the Jaycee White House to the Jaycee president was plainly a case of employer convenience because of the special facts of the employment.⁵⁶ By eliminating from its consideration

that the mere availability of nearby housing, so heavily relied upon by the Tax Court, was intended to require a different result. The language of the regulation which pertains to the feasibility of performance without the furnished housing (*i.e.*, 'because the employee could not perform the services required of him unless he is furnished such lodging') is joined disjunctively ('or') with the phrase concerning the requirement that the employee be available at all times. If the regulation intended that an employee whose duties required constant availability also must have no access to feasible alternative housing, the two phrases would have been joined conjunctively ('and')." *Caratan v. Commissioner*, 442 F.2d 606, 610 (9th Cir. 1971) (footnote omitted).

52. 334 F.2d 660 (Ct. Cl. 1964).

53. By not requiring that the availability of housing test be met, the court may have confused the 24-hour on-call situation with that in which the employee, although performing some duties at times and places outside the normal work day and office, nevertheless exercises almost complete discretion over how and when the duties of employment will be performed.

54. See text accompanying note 50 *supra*.

55. *United States Junior Chamber of Commerce v. United States*, 334 F.2d 660, 664 (Ct. Cl. 1964).

56. The Jaycee president was required to headquarter in Tulsa, Oklahoma for one year, possibly incurring double expenditures for housing. Also, the president was gen-

the availability of housing test when the employee was not on twenty-four-hour call, however, the court ignored the basic premise of section 119, which is to exclude the value of accommodations furnished only when the employer retains maximum control over the employee's enjoyment of them. Furnishing meals or lodging for a substantial noncompensatory business reason is not equivalent to furnishing meals or lodging without which the employee may not perform his job. The strict necessity test is no longer a detriment to seeking exclusion if *Junior Chamber* is the law; this test has in fact been greatly relaxed in recent cases.

The "direct nexus" test for determining convenience of the employer was enunciated in *McDonald v. Commissioner*,⁵⁷ in which the Tax Court stated that there must be a certain degree of connection between satisfactory performance of an employee's duties and the furnishing of housing. In that case the employer, Gulf Oil, argued that it provided housing to United States citizens employed at its Tokyo operation in order to facilitate their transfer. Gulf also argued that the company was primarily benefited because it would otherwise have difficulty both in obtaining employees for the Japanese operation and in insuring their satisfactory performance free from worries about the basics of existence in a new and foreign environment. The court indicated that the case could have been decided solely on either the convenience of the employer or the business premises issue. The court discussed both issues, however, and held that, while Gulf was undeniably benefited by the practice, the employees were the ones who were primarily benefited. Improved efficiency, lack of availability of American-style lodging, and difficulty in obtaining employees to work overseas, the court determined, did not provide a sufficiently direct nexus between the furnished lodging and the employer's convenience to bring the case within the ambit of section 119.

In August 1977, the Court of Claims decided *Adams v. United States*,⁵⁸ a case which on its facts was strikingly similar to *McDonald*. Fanuiel Adams, president of Mobil Sekiyu Kabushiki Kaisha, a Tokyo

erally a young man of limited income who could not be expected to obtain facilities of the type required on his own. Third, the employer would be greatly inconvenienced by the alternative of paying a salary and requiring the new president to seek such housing — a situation tantamount to moving a portion of its offices each year.

57. 66 T.C. 223 (1976).

58. 77-2 U.S. Tax Cas. ¶ 9613 (Ct. Cl. 1977).

corporation wholly owned by Mobil Oil Corporation, was provided by his employer with a "choice" three-level residence located three miles from Sekiyu's headquarters. Residences were routinely procured for Mobil employees both as part of a policy of attracting qualified employees to the Japan operation and for the purpose of removing inequities in employment conditions between Japan and United States based employees. The house, which had been built by Mobil expressly for its chief executive officer, was designed to be used for business activity as well as for the president's personal use. Mr. Adams was required to live in this residence because the company felt "prestigious surroundings" for its president were necessary in Japan for reasons of "face": "[i]f the president of Sekiyu had not resided in a residence equivalent to the type provided the plaintiff, he would have been unofficially downgraded and slighted by the business community and his effectiveness for Sekiyu correspondingly impaired."⁵⁹ Adams included in income only the amount subtracted from his salary for comparable housing in the United States⁶⁰ and contended the remainder was excludable from gross income under section 119.

In applying the direct nexus test, the Court of Claims relied on many of the same business interest factors held insufficient in *McDonald v. Commissioner*.⁶¹ The court held that, when these factors were added to the factors of "prestige consideration" and Sekiyu's formal requirement that its president live in the furnished residence,⁶² the scales were tipped in favor of employer convenience. The court also restated the direct nexus test to require a close relationship between the housing furnished and the "business interests of the employer" (as opposed to "satisfactory performance of the employee's duties").⁶³ This slight shift in emphasis has the potential effect of allowing exclusion to a number of taxpayers in cases when it is difficult to separate regular compensation from the business interest of the employer

59. *Id.* at 88,055.

60. \$4,439 in 1970 and \$4,824 in 1971. *Id.*

61. 66 T.C. 223 (1976). The factors relied on by the Court of Claims included the claims that Sekiyu otherwise would have had difficulty in attracting suitable employees and that the housing subsidy was designed to maintain an equitable compensation relationship between domestic and foreign-based employees. See *Adams v. United States*, 77-2 U.S. Tax Cas. ¶ 9613 at 88,057 (Ct. Cl. 1977).

62. The formal requirement of the employer is not dispositive of the test in any jurisdiction. See note 48 & accompanying text *supra*.

63. *Adams v. United States*, 77-2 U.S. Tax Cas. ¶ 9613 at 88057 (Ct. Cl. 1977).

but when the employment could be performed quite satisfactorily without the furnishing of lodging or meals.

If prestige is the only factor distinguishing *Adams v. United States*⁶⁴ from *McDonald v. Commissioner*⁶⁵ and if *Adams* is the law as to interpretation of the convenience of the employer rule, almost any business executive whose employer can conjure up a sufficient "business interest" which dictates the furnishing of meals or lodging will be allowed to exclude their value from income. A taxpayer in essentially the same posture with less creative counsel will receive no such exclusion. Similarly, an employee, such as *McDonald*⁶⁶ or *Olkjer*,⁶⁷ who is provided with accommodations by the employer because the employee would find it difficult to acquire lodging or meals for herself may be denied the exclusion on the grounds that providing the meals or lodging "directly" benefits both employer and employee. Although it is debatable whether section 119 was intended to provide for exclusion in either the *McDonald* or *Adams* cases, to allow the exclusion in one situation and not the other does not seem warranted by the language or statutory history of section 119.

Another area of inconsistency in present application of the convenience of the employer rule is the distinction between cases in which the employer furnishes meals or lodging and cases in which, for identical reasons, the employer pays higher wages or gives cash reimbursement for meals or lodging. The employer who provides housing or meals and "requires" that the employee accept them provides the employee with additional compensation in the form of an exclusion from income which is not afforded to a worker whose employer merely requires that the duties of employment be performed satisfactorily and leaves where the employee lives and what he eats to the employee.

Two examples from the Treasury Regulations illustrate the effect of the distinction. Under Treasury Regulation 1.119-1(d)(3),⁶⁸ a bank teller who is furnished meals on the bank premises without charge because he has only a thirty-minute lunch break is allowed

64. 77-2 U.S. Tax Cas. ¶ 9613 (Ct. Cl. 1977).

65. 66 T.C. 223 (1976).

66. *McDonald v. Commissioner*, 66 T.C. 223 (1976).

67. *Olkjer v. Commissioner*, 32 T.C. 464 (1959). See text accompanying note 50 *supra*.

68. Treas. Reg. § 1.119-1(d)(3), T.D. 6745, 1964-2 C.B. 42.

to exclude the value of his meals from income, if during that time he would be unable to obtain a meal outside the bank. Treasury Regulation 1.119-1(d)(8),⁶⁹ refuses to allow factory workers who purchase their meals from the factory cafeteria to exclude their value because those employees have the choice of bringing their meals or eating in the lunchroom. The stated distinctions between the above illustrations — that the bank teller's lunchbreak is short and that the factory employees have the choice of eating at the cafeteria or bringing their lunches — are not convincing and emphasize the difficulty of logical and equitable operation of the section. The bank teller has an equal opportunity to bring his or her lunch. The factory workers, on the other hand, may find it difficult to go outside the factory to eat either because of a short lunch-break or because no other facilities are available to them. The real factor distinguishing the two situations, beyond the fact that the factory worker pays a varying amount for his or her meal and thereby violates the cash/in kind rule of the statute,⁷⁰ is that the factory owner does not require that the employee eat on the premises but merely requires that the employee be at work on time. The requirement that the employee eat on the premises reflects employer attitudes rather than any real difference in the compensation obtained by the two employees or the business necessity of their being available, as neither is on call during the break.

Business Premises

The third test of the statute, that the meals or lodging be furnished on the business premises of the employer, has usually received a strict geographic construction by the courts:

The statute does not say "at some convenient or reasonably accessible" place; it does not say "in any nearby building" owned by the employer. It says "on the business premises" of the employer. These words mean what they say and should not be given any strained or eccentric interpretation so as to frustrate what the Legislature obviously tried to achieve.⁷¹

69. Treas. Reg. § 1.119-1(d)(8), T.D. 6745, 1964-2 C.B. 42.

70. Treas. Reg. § 1.119-1(a)(3)(ii), -1(d)(4), (7), T.D. 6745, 1964-2 C.B. 42. See note 125 & accompanying text *infra*.

71. *Dole v. Commissioner*, 43 T.C. 697, 708 (1965) (Raum, J., concurring), *aff'd per curiam*, 351 F.2d 308 (1st Cir. 1965).

*Commissioner v. Anderson*⁷² provides a clean application of the test. Anderson, who managed a motel and was required to be on twenty-four-hour call, moved from the motel rooms occupied by his family (tax free) to a house "two short blocks" from the motel. The move was prompted by the motel owner because of the revenue loss occasioned by Anderson's occupying the rooms. His duties before and after the move were identical. The trial court allowed the exclusion, noting that previous cases had rarely been decided on the "business premises" issue.⁷³ The appellate court reversed, strictly construing the statutory language: "on" was not "near." The court defined "business premises" as either (1) living quarters constituting an integral part of the business property or (2) premises on which the company carries on business activities.⁷⁴ The change from the House's "place of employment" language to the present wording was determined to be without effect.⁷⁵ The court held that the employer's ownership of the premises should not be decisive. An opposite result would allow meals or lodging furnished on nonowned premises to be excluded while allowing mere ownership to provide a convenient basis for exclusion. Both outcomes would be contrary to the section's intent.⁷⁶

The "element of arbitrariness" which, the *Anderson* court noted,⁷⁷ is found in any bright-line test is even more pervasive than usual in application of the business premises rule. In *Lindeman v. Commissioner*,⁷⁸ a hotel operator case very near *Anderson* on its facts, exclusion was allowed. Mr. Lindeman's house was situated on land leased by the corporation adjacent to the hotel parking lot which was located across the street from the hotel proper. The court distinguished *Anderson*, finding that the Lindeman home was "an indispensable and inseparable part of the hotel property . . . within . . . [its] perimeter," while Mr. Anderson's residence was located two blocks from the motel.⁷⁹ In determining that the Lindeman residence was an integral part of the business premises, the court an-

72. 371 F.2d 59 (6th Cir. 1966), *cert. denied*, 387 U.S. 906 (1967).

73. *Anderson v. Commissioner*, 42 T.C. 410, 416 (1964), *rev'd*, 371 F.2d 59 (6th Cir. 1966), *cert. denied*, 387 U.S. 906 (1967).

74. *Commissioner v. Anderson*, 371 F.2d 59, 66 (6th Cir. 1966), *cert. denied*, 387 U.S. 906 (1967).

75. *Id.* at 64. See note 38 & accompanying text *supra*.

76. *Id.* at 67.

77. *Id.*

78. 60 T.C. 609 (1973).

79. *Id.* at 617.

alyzed the functions performed by the employee at his lodging.⁸⁰ The court concluded that a "substantial portion" of Lindeman's duties was performed there even though Lindeman's duties did not differ from those held to be not substantial in *Anderson*.

If *Lindeman* "sapped [*Anderson*] of its vitality to the point of extinction"⁸¹ by allowing a functional analysis of the business premises rule, *Adams v. United States*⁸² completed the process, at least as to employer-owned premises. Following *United States Junior Chamber of Commerce v. United States*,⁸³ and a revenue ruling⁸⁴ which excluded rental value of the official residence from a state governor's income, the *Adams* court equated a showing of the employer's business interest in maintaining the residence with the determination establishing that the house was "on the business premises" for the purposes of the statute. Once the business premises test is interpreted to infer "a functional rather than a spatial unity,"⁸⁵ the factors deemed relevant in deciding the business premises issue look much like those which determined convenience of the employer.⁸⁶ If this result is reached, the third test of section 119 is rendered meaningless. Although the business premises test in the Code is arbitrary, an opinion voiced even by those courts which honor it,⁸⁷ that test is contained in the statute. The functional analysis of *Adams* contradicts the policy of strict construction of statutorily granted exclusions and deductions.⁸⁸

The state trooper cases provide an example of a situation in which the courts have given widely divergent interpretations to the business premises requirement. Four circuits have recognized the

80. This analysis is similar to that in *United States Junior Chamber of Commerce v. United States*, 334 F.2d 660 (Ct. Cl. 1964). As the court noted, Lindeman sought a favorable ruling on a strict geographic basis. The court apparently did not feel an exclusion should be granted without an examination of the extent of the employee's duties performed in his lodging. 60 T.C. at 616 n.5.

81. 60 T.C. at 617 (Tannenwald, J., concurring).

82. 77-2 U.S. Tax Cas. ¶ 9613 (Ct. Cl. 1977).

83. 334 F.2d 660 (Ct. Cl. 1964). See notes 52-56 & accompanying text *supra*.

84. Rev. Rul. 75-540, 1975-2 C.B. 53.

85. *Adams v. United States*, 77-2 U.S. Tax Cas. ¶ 9613 (Ct. Cl. 1977).

86. "(1) the residence was built and owned by the employer . . . (3) the employee was required to live in the residence, (4) there were many business activities for the employee to perform after normal working hours" *Id.* at 88059.

87. *Koerner v. United States*, 550 F.2d 1362, 1364 (4th Cir. 1977); *Commissioner v. Anderson*, 371 F.2d 59, 67 (6th Cir. 1966), *cert. denied*, 387 U.S. 906 (1967).

88. See, e.g., *Commissioner v. Jacobson*, 336 U.S. 28, 47-49 (1949); *Helvering v. Northwest Steel Rolling Mills*, 311 U.S. 46, 49 (1940).

special nature of the state as an employer,⁸⁹ to hold that the premises of the state extend to "every road and highway in the state twenty-four hours a day."⁹⁰ Because the state can regulate and tax all land within its borders, these courts held that the state exercised such a degree of control that it was appropriate to regard all of the state as "business premises." The First⁹¹ and Fourth⁹² Circuits, following the strict interpretation of the statute,⁹³ did not subscribe to the "metaphysical concept" of the Employer State with all-encompassing business premises: "The state conducted no business in the public restaurant. Nor was taxpayer performing, or going to perform, any business there [T]he restaurant was not 'a place where the employee performs a significant portion of his duties.' Rather, taxpayer was there because he was off duty."⁹⁴

The In Kind Rule

Even the courts which have denied the exclusion to highway troopers seem uncomfortable with the business premises test, perhaps because of its arbitrariness and difficulty of application to certain situations. Most of the courts denying the exclusion, including the Supreme Court in the recent case of *Commissioner v. Kowalski*,⁹⁵ have chosen to base their decisions on another factor: whether the meals were furnished to the taxpayer or whether he was reimbursed for out-of-pocket expense in purchasing the meal from a restaurant. Although the statutory intent was to exclude the value of meals and lodging furnished in kind only,⁹⁶ extension of the convenience of the employer rule to encompass cash reimbursements has seemed logical to the bulk of courts deciding state trooper cases.

Saunders v. Commissioner,⁹⁷ decided just prior to the effective date of the 1954 Code, best illustrates the rationale for extending the rule to allow exclusion of cash payments from income. The

89. *United States v. Keeton*, 383 F.2d 429 (10th Cir. 1967); *United States v. Morelan*, 356 F.2d 199 (8th Cir. 1966); *United States v. Barrett*, 321 F.2d 911 (5th Cir. 1963); *Saunders v. Commissioner*, 215 F.2d 768 (3d Cir. 1954).

90. *United States v. Barrett*, 321 F.2d 911, 912 (5th Cir. 1963).

91. *Wilson v. United States*, 412 F.2d 694 (1st Cir. 1969).

92. *Koerner v. United States*, 550 F.2d 1362 (4th Cir. 1977).

93. See note 71 & accompanying text *supra*.

94. *Wilson v. United States*, 412 F.2d 694, 696 (1st Cir. 1977).

95. *Commissioner v. Kowalski*, 98 S. Ct. 315 (1977).

96. See note 34 & accompanying text *supra*.

97. 215 F.2d 768 (3d Cir. 1954).

State of New Jersey had provided meals at way-stations operated by its highway patrol but found that the practice was neither economical nor efficient because troopers were required to drive many more miles per day to reach the stations and the state's roads were left unguarded during meal hours. Therefore, purely for its own convenience, the state allowed the troopers to eat at designated restaurants along the highway and reimbursed them for their expense to a stated maximum. The *Saunders* court adopted an expanded convenience of the employer test, rejecting the cash/in kind distinction as artificial. The court reasoned that, if providing the meals in the first case had been convenient, the reimbursement procedure was clearly more convenient for the state's purposes. The *Saunders* rationale was widely followed in cases in which the amount of the reimbursement accurately reflected the amount expended, the troopers were actually on call during their meals, the troopers were in fact called to duty on occasion, and in which other indicia of employer control over the troopers during the meal were present.

The Tax Court⁹⁸ in *Commissioner v. Kowalski*⁹⁹ did not follow the *Saunders* common law convenience of the employer rule because, it reasoned, enactment of the Code section limited availability of the exclusion to cases meeting the tests of section 119. Because cash allowances did not fall under the statutory rule, the exclusion was denied.¹⁰⁰ On appeal, the Third Circuit stated *per curiam*¹⁰¹ that it had not been persuaded to abandon the *Saunders* rule and allowed the trooper to exclude the value of his meals, even though *Saunders*' employer exercised very little control over when and where the meals were eaten. Although the troopers were on call throughout their lunchbreak, they could eat anywhere they chose, and they were not required to spend any part of the meal allowance on food.¹⁰² The Supreme Court reversed, holding that section 119, as the exclusive authority for allowing exclusion of the meals, does not cover cash payments of any kind.¹⁰³

98. *Kowalski v. Commissioner*, 65 T.C. 44 (1975).

99. 98 S. Ct. 315 (1977).

100. The taxpayer was allowed to deduct under I.R.C. § 162(a)(2) that portion of his food allowance spent for meals eaten while away from home overnight. 65 T.C. at 60-61.

101. *Kowalski v. Commissioner*, 76-2 U.S. Tax. Cas. ¶ 9769 (3d Cir. 1976).

102. The amount of the meal allowance varied with rank. *Commissioner v. Kowalski*, 98 S. Ct. 315, 318 (1977).

103. *Id.* at 324-25.

In basing the decision in *Kowalski* on the intent of the legislature to exclude only in kind meals and lodging, the Court did not comment on several aspects of the current interpretation of section 119 which have given difficulty to the lower courts. *Kowalski* could have been decided solely on the business premises issue, a limitation expressed in the section itself and therefore a clearer expression of legislative intent than the cash/in kind rule. Strict construction of the business premises test would have done much to reduce the exclusion to its original proportions by reinstating the strict necessity requirement abandoned by the holdings of *United States Junior Chamber of Commerce v. United States*¹⁰⁴ and *Adams v. United States*.¹⁰⁵ The courts are now in the precarious position of broadly interpreting the business premises language, a test enunciated in section 119, while requiring strict adherence to the in kind rule which is to be found only in the legislative comment.

It might be argued that the special nature of the state trooper's employment would make the business premises rule difficult to apply in these situations. However, the Court's reliance on the cash/in kind rule for its holding is no less arbitrary and equally fails to consider the special nature of the state trooper's employment. The Supreme Court was able to avoid any discussion of the merits of the *Saunders* construction of the convenience of the employer rule as it applies to state troopers by holding that the enactment of section 119 definitively limited exclusion under the rule to those cases satisfying the tests contained in the section. The Court's position fails to address the logic of the Third Circuit's position in *Saunders*, namely that, if the convenience of the employer is the paramount test, exclusion of cash reimbursements should be allowed when there is a clear showing that the meals are provided for the convenience of the employer and that it is impractical for the employer to provide the meals in kind.

Because of the narrowness of the Supreme Court's ruling and the special facts of the *Kowalski* case, the Court fails to offer any guidance in situations which might vary from the facts of that case. As the Court noted, even under the *Saunders* rule *Kowalski* could not have taken the exclusion.¹⁰⁶ But a question does exist as to what

104. 334 F.2d 660 (Ct. Cl. 1964).

105. 77-2 U.S. Tax Cas. ¶ 6745 (Ct. Cl. 1977). See notes 52-63 & accompanying text *supra*.

106. *Commissioner v. Kowalski*, 98 S. Ct. 315, 325 (1977).

the Court would have decided on facts similar to *Saunders* in which the reimbursement reflected amounts expended and the trooper was required to eat at a designated restaurant and time. Further, the case offers no guidance to states that wish to provide their patrolmen with the exclusion. Because the case did not deal with the business premises issue, there is no indication whether value of meals will be excluded for the state trooper's income if the state allows designated restaurants to bill it for the costs of the troopers' meals. In such a situation, the restaurant might be regarded as an agent of the state, particularly if an agency relationship is created by legislative fiat or by a simple declaration of that fact by the parties.

The cash/in kind rule is itself of questionable validity. The reasoning of the legislature and of the Court in *Kowalski*, stemming in part from the tenet that cash is presumptively compensatory, echoes the early days of the common law rule when no exclusion was allowed if the meals or lodging provided were deemed to have been regarded even partly as compensation to the employee.¹⁰⁷ Whatever the merits of this position, it conflicts with the clear statement of section 119 that the compensatory element of the meals or lodging will be ignored if the accommodations are truly furnished for the convenience of the employer.

Further, there is some question as to whether a reading of the legislative history of section 119 should take into account section 120,¹⁰⁸ a provision in the 1954 Code which excluded from income cash allowances to state policemen to a \$5 per day maximum. This section was repealed four years after passage,¹⁰⁹ with the comment

107. See notes 21-25 & accompanying text *supra*.

108. Int. Rev. Code of 1954, ch. 736, § 120, 68A Stat. 39 (repealed 1958).
Section 120 provided:

“(a) GENERAL RULE. — Gross income does not include any amount received as a statutory subsistence allowance by an individual who is employed as a police official by a State, a Territory, or a possession of the United States, by any political subdivision of any of the foregoing, or by the District of Columbia.

(b) LIMITATIONS. —

(1) Amounts to which subsection (a) applies shall not exceed \$5 per day.

(2) If any individual receives a subsistence allowance to which subsection (a) applies, no deduction shall be allowed under any other provision of this chapter for expenses in respect of which he has received such allowance, except to the extent that such expenses exceed the amount excludable under subsection (a) and the excess is otherwise allowable as a deduction under this chapter.”

109. Technical Amendments Act of 1958, Pub. L. 85-866, § 3, 72 Stat. 1606 (1958).

that the exclusion was inequitable with regard to other taxpayers who must incur like expenditures without benefit of tax break.¹¹⁰ Repeal of section 120 was intended to have the effect of requiring that the troopers make their case for exclusion of the reimbursement under the tests applicable to all other taxpayers.¹¹¹ By repealing section 120 the legislature may have intended to deny unilaterally the exclusion to state troopers because few states would be prepared to furnish the meals in kind. It could be argued, however, that the "in kind" comments affixed to the original section 119 were intended to apply to types of employment other than that of state troopers and that, once section 120 was removed from the Code, the blanket ban on exclusion from income of cash payments should be lifted as to the state trooper if the convenience of the employer test were otherwise satisfied.¹¹²

The Supreme Court in *Commissioner v. Kowalski*¹¹³ also failed to clarify the validity of a series of holdings which were related to *Saunders v. Commissioner*¹¹⁴ but which did not involve cash reimbursements. In *Tougher v. Commissioner*,¹¹⁵ an employee of the Federal Aviation Agency stationed at Wake Island was not allowed to exclude from income¹¹⁶ the value of groceries purchased from the FAA commissary even though there was no other practically available source for meals on the island. The court noted the intent of the section to exclude the value only of meals furnished in kind but based its denial of exclusion on the ground that groceries were not "meals" within the meaning of the statute.¹¹⁷ The court reasoned that an employer who furnishes a "meal" controls the time, place, duration, value, and content to suit its convenience; the purchase of groceries did not involve these criteria.¹¹⁸

110. S. REP. NO. 1983, 85th Cong., 2d Sess., reprinted in [1958] U.S. CODE CONG. & AD. NEWS 4791, 4803.

111. The Senate comment indicated that one motive for repeal of the section was unhappiness at the number of states which were changing their compensation systems to qualify for the statutory exclusion. This practice was felt to thwart the intent of the statute to recognize the special nature of the employment. *Id.*

112. *Commissioner v. Kowalski*, 98 S. Ct. 315, 324-25 (1977).

113. 98 S. Ct. 315 (1977).

114. 215 F.2d 768 (3d Cir. 1954).

115. 51 T.C. 737 (1969).

116. Actually, the taxpayer attempted to deduct the amount expended on groceries. The court elected to treat the maneuver as an attempt at exclusion from income under section 119. *Id.* at 743-44.

117. *Id.* at 745-46.

118. *Id.* at 745.

The definition of "meal" as "food that is prepared for consumption at such recognized occasions as breakfast, lunch, dinner, or supper" was rejected by the Third Circuit in *Jacob v. United States*.¹¹⁹ In that case groceries were provided, in kind, to the director of a mental institution who was required to be on twenty-four-hour call. The court noted that the only difference between an employer's furnishing prepared meals and furnishing groceries is that the employer is relieved of the intermediate task of preparing the meal. The central focus of availability of the employee on the premises remains the same: furnishing groceries may simply be more "convenient" for the employer. "We see no logical reason why entitlement to the exclusion contained in section 119 should hinge upon who cooks the meal."¹²⁰

Jacob relied on the state trooper cases' allowance of exclusion to support its broad reading of section 119,¹²¹ although none of those cases dealt with the definition of "meals." In *Kowalski v. Commissioner*,¹²² the Third Circuit relied on the *Jacob* recognition of the broader definition of "meals" expressed in the state trooper cases in allowing *Kowalski* to take the exclusion. The Supreme Court in *Kowalski*¹²³ impliedly overruled *Jacob* by its strict reading of the statutory intent as to the cash/in kind issue, but it is by no means certain that *Jacob* has lost its validity as to the meals/grocery issue because the discussion in *Kowalski* did not mention this variation on the rule.

Kowalski did not consider another situation in which exclusion has been allowed but which is scarcely distinguishable from the cash reimbursement scheme: the situation in which the employer deducts a fixed amount from the employee's paycheck as payment for the furnished meals.¹²⁴ The exclusion is allowed provided the em-

119. 493 F.2d 1294 (3d Cir. 1974).

120. *Id.* at 1296. Rev. Rul. 77-80, 977-1 C.B. 36, which denied an exclusion to members of a religious order who were given a cash allowance to buy groceries, however, ignored *Jacob* and required that the allowance be included in income on the basis that groceries were not meals within the terms of the section. The fact that the groceries were not furnished in kind was not considered.

121. *Jacob v. United States*, 493 F.2d 1294, 1297 (3d Cir. 1974).

122. *Kowalski v. Commissioner*, 76-2 U.S. Tax Cas. ¶ 9769 (3d Cir. 1976). By relying on *Jacob v. United States*, 493 F.2d 1294 (3d Cir. 1974), rather than on *Saunders v. Commissioner*, 215 F.2d 768 (3d Cir. 1954), the Third Circuit avoided any consideration of the effect of the enactment of § 119 on the common law rule.

123. *Commissioner v. Kowalski*, 98 S. Ct. 315 (1977).

124. Treas. Reg. § 1.119-1(a)(3)(ii), T.D. 6745, 1964-2 C.B. 42.

ployee is able to meet the convenience of the employer and business premises tests of section 119.¹²⁵ Allowance of the exclusion is warranted in light of the section's statement that the labeling of meals and lodging as compensatory is not determinative,¹²⁶ especially because the labeling may be primarily a bookkeeping procedure for employers who must include the value of such accommodations as "wages" or "compensation" for tax or other purposes.¹²⁷ The Treasury Regulations allow the exclusion in this situation if the employee is charged an "unvarying amount," regardless of whether or not he actually accepts the meals or lodging.¹²⁸

In practice, however, the difference between the employment situations in which exclusion is permitted and those in which it is not is difficult to see. In Revenue Ruling 67-259,¹²⁹ an Army hospital, which formerly furnished meals to its civilian food service employees for which they were charged a fixed sum, changed its policy to eliminate the payroll deduction and to provide that employees would make cash payment for all meals consumed. All other conditions remained the same. The exclusion was allowed in the former situation; in the latter it was not. It could be argued that under the new procedure the convenience to the employer was greater because accounting procedures were simplified and amounts paid by employees more nearly reflected the value of the meals consumed. The Ruling based its disparate treatment of identically situated employees on the purely formal change in the procedure by which meals were furnished to the employees. This is a somewhat anomalous result in view of the fact that section 119 was enacted in part to counteract the effect of a formal characterization of meals or lodging as "compensatory."

Basis for Exclusion Outside Section 119

The taxpayer who wishes to exclude a cash reimbursement for meals from income may attempt to look beyond section 119 for aid.

125. The logical gymnastic which allows such accommodation to be regarded as furnished in kind is explained as follows: "In *Boykin* the mandatory withholding of a fixed amount for rent from the employee's formally designated salary could be regarded in substance as restating his true salary to be the diminished amount thereof, and the employer could be regarded as furnishing the employee the lodging in kind." *Tougher v. Commissioner*, 51 T.C. 737, 744-45 n.6 (1969).

126. See notes 31-32 & accompanying text *supra*.

127. See Rev. Rul. 73-381, 1973-2 C.B. 125; Rev. Rul. 72-385, 1972-2 C.B. 535; *Mim*, 5657, 1944 C.B. 550.

128. Treas. Reg. § 1.119-1(a)(3)(ii), T.D. 6745, 1964-2 C.B. 44.

129. 1967-2 C.B. 76.

For example, the taxpayer in *Commissioner v. Kowalski*¹³⁰ argued that the meals allowance was not "income" as defined in section 61 and, further, that a line of cases and rulings recognized a common law convenience of the employer exclusion from income in cases in which the allowance was not compensatory.¹³¹ Trooper Kowalski argued that, although "income" under section 61 is defined broadly, it is not all-inclusive, as evidenced implicitly by the number of statutes defining the term and by the fact that "gross income" in a business context is defined otherwise.¹³² The trooper pointed to the fact that the exclusion from income of commutation of rations and quarters for the Armed Forces, the Coast and Geodetic Survey, and the Public Health Service is promulgated generally under section 61 and not under any specific statutory provision.¹³³ The ruling applies even to the National Guard, although that body is technically an arm of the state. Some fringe benefits,¹³⁴ including "supper money" for employees, are also excluded from income under section 61.¹³⁵ These exclusions seem to indicate that the convenience of the employer doctrine is alive and well in common law and is not exclusively embodied in section 119. This conclusion is buttressed by the fact that the Senate added the old term to the statutory test, possibly intending to incorporate the common law doctrine where it was not explicitly contradicted by other portions of the statute. *Saunders v. Commissioner*¹³⁶ would therefore be relevant as regarding payments not intended to be compensatory.

130. 98 S. Ct. 315 (1977).

131. Brief for Respondent at 9-21, *Commissioner v. Kowalski*, 98 S. Ct. 315 (1977).

132. *Id.* See I.R.C. §§ 71-84; Treas. Reg. § 1.61-3, T.D. 7285, 1973-2 C.B. 163.

133. Brief for Respondent at 13-21, *Commissioner v. Kowalski*, 98 S. Ct. 315 (1977) (citing Treas. Reg. § 1.61-2(b), T.D. 6856, 1965-2 C.B.30). However, the same regulation specifically denies an exclusion for meals and lodging furnished by an employer unless the taxpayer meets the test of § 119. Treas. Reg. § 1.61-2(b), T.D. 6856, 1965-2 C.B. 30.

134. No regulation embodies the fringe benefit rule as such. The principles underlying the tacit recognition of the Service that such items need not be reported seems to be lack of employer inconvenience and the practical difficulties of valuation, withholding, and enforcement if such benefits were required to be reported. See *Summary & Explanation of Discussion Draft of Proposed Regulations on Fringe Benefits*, 40 Fed. Reg. 41118 (1975). For an exhaustive discussion of the rule, see Note, *Federal Income Taxation of Employee Fringe Benefits*, 89 HARV. L. REV. 1141 (1976).

135. The legislative guide to the 1954 Code notes that "supper money" may not be excluded from income under the provisions of § 119. GUIDE TO THE INTERNAL REVENUE CODE OF 1954, 84th Cong., 1st Sess., reprinted in [1955] U.S. CODE CONG. & AD. NEWS 1183, 1228.

136. 215 F.2d 768 (3d Cir. 1954).

Along with every court which has considered a section 119 case, the Supreme Court in *Commissioner v. Kowalski*¹³⁷ gave short shrift to the section 61 argument. After *United States v. Glenshaw Glass*¹³⁸ and *Commissioner v. LoBue*¹³⁹ it is difficult to argue successfully that a benefit rendered to the taxpayer by his or her employer will not be considered income, particularly when the payment is in cash, which is presumptively compensatory.¹⁴⁰ The Supreme Court is on firm ground when it simply states that all accessions to wealth are income unless specifically excluded by statute,¹⁴¹ even though this statement overlooks the existence of the fringe benefit and Armed Services rules, under which the exclusions are not granted by statute.¹⁴² The Court also destroyed any hope of a basis for exclusion in the common law rule.¹⁴³ There is some question concerning the intent of the Senate in adding the "convenience of the employer" term to the statutory test, but the Court had little difficulty in determining that the legislature by both expanding the former law (to include meals and lodging characterized as compensatory) and contracting it (by the business premises test) did not intend to incorporate the law already existing around that term but rather intended to replace the former law with section 119.¹⁴⁴

An attractive alternate ground for avoiding a tax on the value of meals and lodging has been suggested by several courts: a deduction of their value from income under section 162(a)(2) as an ordinary and necessary expense of being an employee.¹⁴⁵ The same factors which indicate that accommodations are furnished for the convenience of the employer will generally allow those accommoda-

137. 98 S. Ct. 315 (1977).

138. 348 U.S. 426 (1955).

139. 351 U.S. 243 (1956).

140. *Saunders v. Commissioner*, 215 F.2d 768, 771 (3d Cir. 1954).

141. 98 S. Ct. at 319.

142. The Court in *Kowalski* specifically did not decide whether the "supper money" exclusion might be justified on grounds other than § 119. 98 S. Ct. 315, 324 n.28. There is no question that the Service has the power to tax such fringe benefits; witness the \$50,000 limitation imposed on group-term employee life insurance, an area previously regarded as within the fringe benefit rule. I.R.C. § 79.

143. See text accompanying note 103 *supra*.

144. *Commissioner v. Kowalski*, 98 S. Ct. 315, 325 (1977).

145. *Id.* at 326 (Blackmun, J., dissenting); *United States v. Morelan*, 356 F.2d 199 (8th Cir. 1966) (§ 162 deduction proposed as alternate relief had taxpayer not qualified under § 119); *Cooper v. Commissioner*, 67 T.C. 870 (1977) (fireman allowed § 162 deduction on meals eaten at stationhouse).

tions to be considered as business expenses rather than as nondeductible personal expenses under section 262. The chief deterrent to claiming such a deduction is the rule in *United States v. Correll*,¹⁴⁶ which allows the deduction only if the taxpayer stays away from home overnight.¹⁴⁷ The rationale for the overnight rule is that the taxpayer incurs duplicate expenses only when his travel involves expenditures for both meals and lodging; to allow a traveler to take a deduction for meals consumed on short trips would discriminate against commuting workers who must also eat away from home but for whom the cost of meals is a nondeductible personal expense.

The overnight rule has been criticized as an embroidering of the actual intent of the legislature in passing section 162¹⁴⁸ because no reference to this qualification is made either in the legislative comment or in section 162 itself. Nevertheless *Correll* presently stands as the law. It is not within the province of this short Article to deal with the validity of *Correll*, except to say that a taxpayer seeking to deduct the value of meals and lodging would have to overcome the overnight rule to do so or be able in some specific situations to argue that the meals and lodging are ordinary and necessary expenses of a trade or business or for the production of income.

In *Commissioner v. Kowalski*,¹⁴⁹ the Supreme Court did little to resolve the confusion created by a quarter-century of conflicting interpretation of section 119 by the courts. *Saunders v. Commissioner*¹⁵⁰ and the common law convenience of the employer rule are overruled, narrowly, on a set of facts which would not have met the common law standard. After *Kowalski*, cash payments for meals and lodging may not be excluded from income unless they are constructive payments of a fixed sum subtracted from the employee's paycheck. The value of groceries provided to the employee by his or her employer in lieu of meals must likely be included in the employee's gross income, based on an extended reading of the in kind

146. 389 U.S. 299 (1967).

147. The wording "meals and lodging" was seen by the Court in *Correll* as indicating that a § 162 deduction must involve both elements and that the trip must therefore be an overnight one. 389 U.S. at 304 (emphasis added).

148. *Commissioner v. Kowalski*, 98 S. Ct. 315, 326 (1977) (Blackmun, J., dissenting); *United States v. Correll*, 389 U.S. 299, 307 (1967) (Douglas, J., dissenting); *Waters v. Commissioner*, 12-T.C. 414, 416-17 (1949).

149. 98 S. Ct. 315 (1977).

150. 215 F.2d 768 (3d Cir. 1954).

doctrine and an implied overruling of *Jacob v. United States*¹⁵¹ by the Supreme Court. The confusion is compounded by interpretations of the two other statutory tests. The relaxed, "functional" interpretation of the business premises test of *United States Junior Chamber of Commerce v. United States*¹⁵² and *Adams v. United States*¹⁵³ will find a residence to be on the premises of the employer for the purposes of the section if the employee performs a substantial portion of his duties there — duties as to which the employee nonetheless retains almost complete discretion regarding the time and manner of performance. The "direct nexus" interpretation of the employer convenience test will allow one executive to exclude the value of his residence from income while denying the exclusion to another similarly situated.

A Proposal for Equity and Clarity

Any attempt to correct the unequal treatment of taxpayers under section 119 by a reversal of current trends in interpretation of the section¹⁵⁴ will be merely cosmetic if the premise behind operation of the section remains unexamined. It is therefore necessary to question whether there is any justification for the continued existence of a provision which results in such substantial taxpayer confusion and which contains serious elements of actual and potential inequity. As previously stated, the revenue loss created by section 119 is not an insubstantial one,¹⁵⁵ and it is increasing every year. Although the court in *Commissioner v. Kowalski*¹⁵⁶ eliminated one fairly minor cause of revenue loss, it left a multitude of situations which greatly reduce tax revenue and in which taxpayers are treated differently because of the ability of some to sustain a showing that the meals or lodging were furnished for the convenience of the employer. Indeed, if there is any validity to the basic premise of section 119, *Kowalski* reduced that validity by increasing the inequitable operation of the section through the determination that the availability of the exclusion depends on the happenstance of whether the receipt

151. 493 F.2d 1294 (3d Cir. 1974).

152. 334 F.2d 660 (Ct. Cl. 1964).

153. 77-2 U.S. Tax Cas. ¶ 9613 (Ct. Cl. 1977).

154. This might be accomplished, for example, by a return to the strict standard of the business premises test or of an interpretation of the cash/in kind rule consonant with the philosophy of the convenience of the employer doctrine.

155. See note 7 & accompanying text *supra*.

156. 98 S. Ct. 315 (1977).

is in kind or in cash, without any regard for the reason behind the employer's choice of the particular method.

It is the position of the authors that section 119 as presently written is not justified either as a matter of appropriate tax law policy or under the basic concept that voluntary compliance with the tax law is more difficult to elicit if there is inequitable treatment of taxpayers. The section, both by its terms and possibly even to a greater extent by its interpretation, provides a special privilege tax advantage based on the nature of the employment and the ability of the employer and employee to make the necessary environmental adjustment. The fact that it gives tax relief in many cases to the less affluent of our employed does not make it any more palatable. It disguises additional compensation in a myriad of instances in which the convenience of the employer may technically be present but in which the acceptance of the benefit does not place a burden on the employee. The effect is to thus produce a tax break not given to other taxpayers who are in fact similarly situated. In many situations the convenience to the employer results primarily from the fact that the employer is able to pay substantially less in wages than the cost of the items furnished.

It is time to dispel the tax fiction which states that it is a burden for the employee to live or eat on the employer's premises. When one looks at the living accommodations acquired by most highly paid executives, it is difficult to agree with the suggestion implied in the opinion of a court that Adams,¹⁵⁷ as an example, would have chosen substantially more modest quarters than those furnished by his employer if he had been left to his own devices. It is more likely that, if Adams had been required to pay his own costs of lodging in Japan, he would have demanded sufficient additional salary to compensate him for the additional cost over comparable housing in the United States. It appears to be entirely inequitable to give Adams free lodging while another employee transferred to a less important post in Japan by the same company who is not given a company dwelling would either bear the entire burden of increased cost or would pay income tax on the amount reimbursed to him by the employer.

The most desirable way to eliminate the problems created by the operation of section 119 is simply to repeal the section and treat all

157. See generally *Adams v. United States*, 77-2 U.S. Tax Cas. ¶ 9613 (Ct. Cl. 1977).

taxpayers identically as to inclusion in income of payments in cash or in kind. It is true that there may be some administrative difficulty in the valuation of meals and lodging furnished in kind. In many instances, however, the items furnished to the employees are sold to others for cash and could be valued on the same basis. In the comparatively few instances when this procedure is not available, a formula for valuation similar to that used for social security¹⁵⁸ and wage and hours law administration¹⁵⁹ would be a less than perfect but possible solution.

If section 119 is repealed, an employee could still contend that in a particular situation the meals or lodging are essential to the employee's trade or business or to production of income under Internal Revenue Code section 162 or 212 and that, if the value is to be included in income, an offsetting deduction must be allowed. The courts have in special instances allowed the deduction of employee expenses under these sections, such as for work clothes,¹⁶⁰ for employment agency fees,¹⁶¹ and, in at least two Tax Court decisions, for the amount deducted by an employer for meals available to the employee.¹⁶² It could also be argued by the employee that the amount in excess of what he or she can prove would have been the normal expenditure for meals or lodging is a deductible expense under section 162 or 212.¹⁶³ The use of these sections to cover certain special instances would ameliorate some of the more difficult situations and materially reduce the inequity inherent in section 119. But as noted,¹⁶⁴ the employee would still be faced with the "overnight rule" of *Correll v. United States*¹⁶⁵ in attempting to claim a deduction under section 162.

158. 42 U.S.C. § 415 (1973).

159. *E.g.*, 29 C.F.R. § 548.3 (1976).

160. *E.g.*, *Jackson v. Commissioner*, 39 T.C.M. (P-H) 1071 (1970); *Yeomans v. Commissioner*, 30 T.C. 757 (1958); *see* Rev. Rul. 70-474, 1970-2 C.B. 34.

161. *E.g.*, *Cremona v. Commissioner*, 58 T.C. 219 (1972); *Primuth v. Commissioner*, 54 T.C. 374 (1970).

162. *Sibla v. Commissioner*, 68 T.C. 422 (1977); *Cooper v. Commissioner*, 67 T.C. 870 (1977).

163. This approach would be analogous to that used in *Sutter v. Commissioner*, 21 T.C. 170 (1953): "[T]he presumptive nondeductibility of personal expenses may be overcome only by clear and detailed evidence as to each instance that the expenditure in question was different from or in excess of that which would have been made for the taxpayer's personal purposes." *Id.* at 173.

164. *See* notes 146-48 & accompanying text *supra*.

165. 389 U.S. 299 (1967).

After having watched and heard the expostulations of lobbyists for the hotel and restaurant interests concerning attempts to eliminate tax advantages which helped bring about our expense account economy and the attendant lack of appropriate tax reform as a result, it would be naive to expect that a proposal to repeal section 119 would elicit any lesser amount of complaint from corporate executives, hotel and motel operators, representatives of culinary and hotel employee unions, and other interested employees. It is probable that the claim would again be heard that such a change would make it impossible to run a hotel or to obtain employees for restaurants and that universities and certain charitable institutions could not properly perform their worthwhile tasks. Even if these complaints could be substantiated, they do not justify a clear discrimination between taxpayers who in a real sense are identically situated. A method to avert the alleged catastrophe which does not use the tax laws as a vehicle should be adopted. It is submitted, however, that there is very little evidence that the elimination of section 119 would have the deleterious effect claimed by those who now have the benefit of the provisions of the section. Nonetheless, it is unlikely that the drastic change suggested above will be adopted in the near future, especially in view of the fact that repeal of section 119 apparently has not been a part of any recent suggestions for tax reform.

Therefore, any realistic proposals for reducing or eliminating the inequities caused by the operation of section 119 must include an alternative to complete deletion of the section. Although it would not completely eliminate the confusion or inequity, it would be worthwhile to draft an adequate definition of the phrase "convenience of the employer." This is admittedly a difficult task, but it is submitted that, if the exclusion is to be retained, the basis for the exclusion should be that the furnishing of the meals or lodging is *functionally necessary* for the operations of the employer. It is therefore suggested that the current tests of the statute be replaced by the requirement that the meals or lodging be "functionally necessary for the operations of the employer." The burden of proof that an expenditure is functionally necessary to the employer's operation should not be unduly heavy, although it certainly should be more than a formality. A showing that without the furnishing of meals or lodging an essential activity is not feasible of operation or that such furnishing significantly decreases the operating costs (other than an increase in wages which otherwise would be required) or reduces the

number of required personnel may bring the accommodations provided within the modified provision.

Once the functionally necessary test is met, the taxpayer should be allowed to exclude a specified amount without regard to whether the meals and lodging were furnished in kind or as a cash reimbursement and without regard to whether furnished on the business premises of the employer. A schedule of allowances could be established which would afford a complete exclusion to the restaurant employee but would impose some tax consequences on the corporate executive or a hotel by reason of the additional includable income.

If this formula approach is adopted, it would probably be necessary to recognize that there are instances when the facilities furnished to the employee are of substantially greater value than he would have acquired except for the employment but are not realistically compensation. In such cases there should be room for proof of that fact and for an additional exclusion up to full value where the test is met. However, the criteria for meeting this burden of proof should be made so substantial as not to be easily avoided. It should be made clear that the facilities furnished are within the exclusion only when their provision is *essential* to the carrying out of the functions of the employer's business.

Although this proposed alternative to the present section 119 might increase the number of persons benefiting from the rule by allowing the exclusion of cash payments, it is submitted that this exclusion is essential to insure at least some semblance of equitable treatment of taxpayers. The proposal would materially reduce the revenue loss notwithstanding the possible increase in the number of beneficiaries, and would result in a sounder tax law approach. Although it is to be expected that the argument will be made that this alternative will involve too great an administrative burden, there is little evidence that in this age of sophisticated computerization there would be more work in administering the proposed formula than in performing the present task of sorting out and evaluating the multitude of arrangements presently in effect.

It should be remembered, however, that the proposal suggested is only an alternative solution to a problem which could best be remedied by elimination of the exclusion. If we want to achieve the equality and fairness which Justice Robert Jackson said is so essential to the administration of a self-assessment system of taxation, we should get rid of this barnacle on our income tax system.